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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 286

UNITED STATES OF AMERICA, *Appellant*,

v.

DIEBOLD, INCORPORATED, *Appellee*.

On Appeal from the United States District Court for the Southern District of Ohio

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BRIEF FOR THE APPELLEE

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BRIEF FOR THE APPELLEE

QUESTION PRESENTED

The Government's formulation of the Questions Presented is based upon a Government economist's evaluation of the published reports of HHM, the acquired company. But the uncontradicted evidence showed, and the District Court found, (Fdg. 20, R. 567) that "HHM's 'book' figures failed completely to

reflect the actually insolvent condition of the company." Accordingly, if account is taken of the actual condition of the acquired company, as shown by its internal working papers, and as undisputed on the record, the question presented is properly:

Whether the District Court was correct in applying the "failing company" doctrine of the *International Shoe* case where the uncontradicted evidence, as found by the District Court:

(A) established that for the nine months prior to the sale, the acquired company was so critically short of working capital that it was compelled, *inter alia*, (1) to meet its payrolls and pay its past-due creditors through substantial checking account overdrafts that were sustained only through constant manipulation of an elaborate check "floating" scheme; (2) despite the check floating scheme, to permit its past-due and current trade bills to run up to a total of approximately $750,000 at the time of sale; (3) to inflate its bank balances through the simultaneous "paper" deposits in a number of banks of checks for identical amounts representing in fact a single sum of money; (4) to borrow on demand notes to the limit of its principal depository's legal ability to loan; and (5) to permit its balance in its principal depository to decline to a book figure of $13.92, while actual overdrafts in the amount of $73,127.80 were outstanding on this same bank,

(B) established that it was incurring heavy losses and that its condition was in general substantially deteriorating in the period before the acquisition, and

(C) further established that a quick cash sale was made to the only prospective purchaser to which HHM could have in fact made a sale, Diebold, which was unaware of HHM's desperate cash position and true financial condition.

STATEMENT

This is an appeal from a judgment of the District Court for the Southern District of Ohio in favor of appellee, Diebold, Incorporated (Diebold), in a suit brought by the Government under § 7 of the Clayton Act, challenging Diebold's acquisition of the assets of Herring-Hall-Marvin Safe Company (HHM).

The complaint was filed on August 24, 1959. On March 8, 1961, after prolonged discovery had been had by the Government, but before trial of the Government's affirmative case, the Court concluded, on the basis of the extensive proofs of both parties submitted on Diebold's Motion for Summary Judgment, that the acquisition did not violate § 7 because, at the time thereof, HHM was a "failing company".

The District Court found that there was no genuine issue as to any material fact (R. 570), and concluded that at the time of its acquisition by Diebold on September 11, 1959, and for at least nine months prior thereto, HHM was hopelessly insolvent and faced imminent receivership (Fdg. 28, R. 569). The District Court found that because of its precarious financial condition, HHM could not long have survived as an independent competitor in its various lines of business. But for the sale to Diebold, the Court concluded, HHM would have been forced to liquidate its business in insolvency proceedings, with resultant heavy losses to its employees, creditors, and stockholders, and the community it served (Fdgs. 28, 31, R. 569-70; R. 200).

The District Court found that Diebold purchased on HHM's terms, in reliance on HHM's representations, and without adequate access to HHM's books and records. It concluded that Diebold was the only bona fide purchaser for HHM's business; that no one else

ever made an actual offer for HHM; and that by reason of its precarious financial position, HHM could not have achieved a sale to anyone else. With respect to certain other parties who at times had made overtures with respect to HHM, the Court found that "none of these overtures ever approached the concreteness of a firm offer or a firm price and no financial data or operating figures were supplied by HHM" (Fdgs. 26, 29, 30, 31, R. 569-70).

The District Court accordingly ruled that Diebold was entitled to judgment as a matter of law under the "failing company" doctrine of the *International Shoe* case.

* * * *

It is necessary, for a proper understanding of the District Court's judgment, to make a full statement of the undisputed basic facts relating to the "failing company" issue as presented to the Court below. The record is an extensive one. In an important part it is comprised of the special audit reports of independent certified public accountants (Lybrand, Ross Bros., & Montgomery) who analyzed HHM's internal books of account after the acquisition. We shall first set forth the data—based largely upon the company's internal working papers—as to HHM's financial condition in the critical period in 1959, which the District Court deemed controlling. Next, we shall set forth the financial material submitted on the motion by the Government—based almost wholly upon the company's formal reports primarily prepared for creditors and relating to the so-called "long-term"—which the District Court deemed not to be dispositive or controlling on the failing company issue. Finally, we shall set forth the record on certain other aspects of the issue.

A. The Acquisition and HHM's Failing Financial Condition

1. *The Acquisition.*—On September 11, 1959, Diebold acquired the assets of HHM for $3,000,000. The acquisition resulted from an offer by Warren Mosman, President of HHM, of a quick cash sale of HHM's assets. The sale was contingent upon a swift consummation, without complete analysis of HHM's books and records. Diebold purchased on HHM's terms, in reliance on HHM's representations, and without access to HHM's internal books and records (Fdgs. 1, 2, 29, R. 561-62, 569).

2. *HHM's long-term financial background.*—The financial background of HHM before the acquisition showed a pattern of a long-term expansion of sales on a totally inadequate working capital base, followed by a two-year period of constriction in HHM's business, with the last year featured by a desperate shortage of essential working capital to support the business' operations.

From June 1950, down through the date of the acquisition, HHM had been short of working capital (Fdgs. 4, 6, R. 562-63; R. 266, 255). HHM's current ratio (the relationship of its current assets—including inventories and more liquid assets alike—to its current liabilities) averaged only approximately 1.5 for the years 1951 through 1959, in contrast with an average of 2.7 during the same years for all manufacturers of fabricated metal products (Fdg. 6, R. 563; R. 255). Against this backdrop of a continually "thin" current position, HHM's net sales rose from $5,023,270 in 1949 to $6,898,633 in 1954, and to $10,672,279 in 1957 (R. 337, 266).

During this period of growth in HHM's sales volume, not supported by adequate working capital, there oc-

curred from time to time periods of sales "plateaus" in which the annual rate of growth of HHM's sales slowed down or ceased. During these plateaus a sharp increase in the overhead costs of HHM's operations relative to its sales would be experienced. Representative of this manifestation were the periods 1948-50 and 1952-55 (R. 337).

After the record figure of $10,672,279 in sales was reached in fiscal 1957,[1] Mosman set a sales goal of $14,250,000 for 1958 (R. 266). However, 1957 introduced the first postwar recession which Mosman found to be "moderately severe", and HHM's sales for fiscal 1958 amounted only to $10,301,000 or 30 percent less than its quota, and $371,000 less than 1957 (R. 266). For fiscal 1959, Mosman again sought to increase sales and set a more modest quota of $12,500,000, but the company's business continued sluggish and sales fell even below the fiscal 1958 figure, to $10,023,000. Mosman then recognized for the first time that the abnormal demand created by the postwar boom had come to an end and that the level at which normal continuing demand was stabilizing was such as to create a substantial over-capacity for the products of the company (R. 266).

Consequently, competition for the limited amount of business increased sharply and it was necessary for HHM to take orders at lower prices (R. 266). Concomitantly, the conviction was driven in upon Mosman that only a substantial investment of additional capital could produce the improvement of plant facilities and production techniques necessary if the company was

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[1] During the relevant period, HHM was on a fiscal year running from July 1 to June 30, referred to as of the year in which it ended.

to survive (R. 266). However, prospects of improving the efficiency of the plant were severely handicapped by the attitude adopted by the Union (R. 267).

3. *The 1959 Union contract.*—In March 1959, the Union which represented most of the hourly-rated production and maintenance workers in HHM's plant approached HHM for negotiations looking toward a new labor contract. It presented demands for wage costs which were higher than those in the area or in the industry; and the Union refused to allow the company to adopt a "wage incentive" program which was common in the rest of the industry. Although HHM deemed the demands excessive, because of its extremely weak working capital position, the company could not stand a strike, which the Union had threatened. Accordingly, HHM acceded substantially on the terms of the Union. It was then necessary to increase the hourly rates and the fringe benefits of the other employees who were not represented by the Union. Before acceding to the Union's demands, Mosman gave serious consideration to bringing before his Board of Directors a recommendation that the company be liquidated (Fdg. 15, R. 565-66; R. 267).

4. *Practices of HHM with respect to financial statements.*—HHM was a closely held corporation, and on the operating side virtually a one-man operation by Mosman (R. 25, 261). The District Court found that during the 1950's, although the annual balance sheets and profit and loss statements of HHM purported to show a modest annual improvement in the company's financial condition, these "book figures" failed completely to reflect the actual condition of the company (Fdg. 20, R. 567).—The "book figures" were furnished

to, and relied upon by, HHM's source of bank credit (R. 457, 461-62).

The District Court found that HHM's books were made up in accordance with management policy (*Ibid.*). The record reflects various examples of such practices:

(a) The Treasurer of HHM was informed by Mosman in a "Personal and Confidential" memorandum on June 16, 1958, of the following "goals for June 30, 1958"—the end of the fiscal year: "As I told you, I would like the following things done before the end of June . . . I would like to show a net profit, after taxes, of at least $150,000 . . . I would like to show a net worth of approximately $2,100,000." (R. 560). The Treasurer endorsed "O.K." on the memo (R. 560). As of June 30, 1958, HHM's profit and loss statement showed a net profit, after taxes, of $188,814, and the balance sheet showed a net worth of $2,126,502 (Fdg. 20, R. 567).

(b) In 1959, an interim balance sheet, stating receivables as if they were cash, and concealing overdrafts, was issued by HHM (R. 222a; see Fdg. 2, R. 561-62).

(c) On June 30, 1959, the company's books as of the close of its fiscal year omitted $46,858 of checks which had been already issued (R. 228).[2]

5. *The current position of HHM in 1959.*—By 1959, HHM was falling 25 percent below its sales goals. In fact, net sales had shrunk annually by approximately $300,000 per year from the peak fiscal year of 1957

[2] This misstatement was apparently caught in the regular audit of HHM's books by Lybrand, Ross, HHM's regular auditors (R. 228).

(Fdg. 7, R. 563; R. 266). Mosman noticed for the first time the changed, and considerably adverse, conditions with which the company was confronted (R. 266). The shortage of working capital to which the company had been subject for years became acute. In June 1959, HHM's current position was such that its net quick asset ratio (the relationship between cash and Government securities on the one hand, and current liabilities on the other) had dropped to .074.[3] This means that HHM's cash and Government securities, as of that month, amounted to only 7.4 percent of its *current* liabilities. The average figure for all companies in the fabricated metal products industry[4] was 37 percent—five times HHM's figure (Fdg. 6; R. 563, 267, 256).

6. *Internal cash generation inadequate despite partial liquidations.*—This adverse net working capital position had obtained despite the past retention by

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[3] The Government questions the use of this particular ratio (Gov. Br. 10, n. 5). It is a ratio used in the "Quarterly Financial Reports for Manufacturing Corporations" published by the FTC and SEC (R. 255-256). Obviously it is the severest, and, consequently, in an emergency situation, the most important of the financial ratios used to test liquidity. "It is obvious that a business which maintains current assets barely equal to its current liabilities will be in a weak financial condition if half or more of the current assets consist of merchandise and receivables. This would mean that in an emergency requiring payment of all current debt, the merchandise and receivables would need to be sacrificed. Either of these events would mean liquidation." Francis, The Small Businessman and His Financial Statements, (U.S. Dept. of Commerce), p. 16. See also Kennedy, Financial Statements (1947), p. 213.

With HHM, it was not simply a case of cash equal to less than half current liabilities. The ratio ranged from .07 to .03 in the critical period (R. 256, 557).

[4] A term of comparison also used by the Government's accountant. See R. 333.

HHM of substantially all of its earnings after taxes. In an effort to improve its net working capital position, HHM consistently retained substantially all of its earnings; annual dividends paid were less than $12,000 during the late 1950's, and the last such dividend was paid in the fiscal year commencing July 1, 1958 (R. 334, 255). Nor was HHM's position cured by the retention of the proceeds, totalling close to $500,000, from the periodic liquidation of HHM's productive assets. In 1954, HHM received, and retained, $150,000 in insurance proceeds resulting from the destruction by fire of the facilities of a subsidiary, Thomas Manufacturing Company. In fiscal 1955, it sold its Quickdraft Division for $100,000. In fiscal 1959, HHM sold its Remington Division for $90,000, and its Canadian subsidiary for $130,000 (R. 266-67). No distribution in respect of these sales was made. Despite this, the net quick asset ratio of .074, which prevailed in June 1959, was the worst since Mosman took over the company in 1951 (R. 267).

7. *The commencement of operating losses.*—In fiscal 1959 (running from July 1, 1958 through June 30, 1959), sales were falling by approximately $300,000 at an annual rate. During the same period inventories built up by $262,000[5] (Fdg. 8, R. 563; R. 239, 266).

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[5] The Government points to a discrepancy between the inventory build-up reported by Lybrand, Ross in HHM's certified statements and that reported by that firm in its special audit reports filed with the Motion for Summary Judgment (Gov. Br. 12, and n. 6). The figures in the published statements included, in the case of the 1958 balance sheet, HHM's subsidiaries which were sold in fiscal 1959 (R. 266-67, 335). The special audit reports, which we quote, do not. The Government accountant recognized this difference (R. 332). Since it was only HHM's own assets which were sold Diebold, the treatment used in the special report is obviously preferable.

Following the end of the fiscal year 1959, for the period between July 1 and September 10, 1959—the day before the closing—it was later revealed, during the subsequent audit, that HHM had suffered operating losses of $206,953.51 (Fdg. 16, R. 566; R. 222b). On an annual basis, this volume of losses would indicate a loss rate in excess of $1,000,000. The company had not previously in the 1950's had occasion to experience the effects of a losing year when coupled with its continually adverse liquidity position (R. 337).

8. *Badges of insolvency.*—The company's desperate cash and working capital position gave rise to the following manifestations in the critical months of 1959 prior to the acquisition:

(a) *Repeated overdrafts.* HHM's bank balances at its principal depository, The First National Bank and Trust Company of Hamilton, Ohio, reflected modest minimum monthly balances, per statement, during 1959. (The height of modesty in these minimum monthly balances was reached shortly before the acquisition in September 1959, when the company's minimum balance per statement reached $13.92.) (Fdg. 13, R. 564-65; R. 222d). But even these meager balances per bank statements did not reflect HHM's true condition, because the statement balances failed to reflect the overdraft checks sent to creditors, and already in the process of collection, which had not yet cleared the drawee bank.[6]

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[6] The Government has suggested that HHM's bank accounts "were never overdrawn" (Gov. Br. 13). This is, we respectfully submit, an extreme misuse of language. What the Government means is that although HHM habitually sent out checks to its creditors without having money in the drawee bank sufficient to cover them—and frequently with very substantial overdrafts on

On 69 of the 144 working days between April 1, 1959 and the consummation of the sale on September 11, 1959, HHM had checks drawn and outstanding in excess of its actual balance on account at The First National of Hamilton. These daily overdraft figures, conservatively stated, ranged in amounts between $104.51 and $78,394.58.[7] On 41 days during the same

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those accounts by virtue of outstanding checks—by the time that the checks found their way of the drawee bank, funds sufficient to cover them had subsequently been deposited. We submit that most reputable firms and individuals would consider this practice of HHM to be that of writing overdrafts. This usage is confirmed by standard treatises on accounting. See Finney & Miller, Principles of Accounting, Intermediate (5th ed. 1958), p. 188; Guthmann, Analysis of Financial Statements (1953), p. 75. "When the balance sheet has not been audited, a dishonest or an ignorant proprietor has been known to show his bank balance, without regard to his outstanding checks, as cash in the bank." (*Ibid.*) We do not believe that the Government seriously means to adopt the same usage.

[7] The Government suggests that Diebold's figures for HHM's overdrafts were misstated, inasmuch as HHM followed the policy of drawing and dating checks but putting them to one side for a period of months before issuance. Accordingly, the Government suggests that Diebold's figures as to the overdrafts may include an indeterminate number of checks which had not at the time been issued by HHM at all (Gov. Br. 13-14).

But this is an obviously erroneous reading of the record. The independent auditors who computed Diebold's figures for HHM's overdrafts did not treat a check as having been issued and outstanding as of the date on which it was written and dated. Instead, because of HHM's practices, the accountants treated a check as being outstanding only as of the date indicated by the first bank stamp on its back (R. 585-86). Thus, there are no figures included in the overdraft figures for checks which had been drawn and dated but not actually issued.

If anything, the accountants' method of ascertaining when HHM had issued a check—by inspection of the first bank stamp on its back—tended to understate the amount of overdrafts. This is because obviously such a check would have been mailed to the payee sometime in advance of his receipt of it and deposit of it

period the company had total net overdrafts on all of its commercial bank accounts. In other words, applying its balances on account in banks other than The First National of Hamilton to its overdraft there,[8] a net overdraft position would still be revealed on 41 of the 114 working days in the last five and a half months before the acquisition. These overall net overdrafts, on a daily basis, varied from $1,123.72 to $66,890.68 (Fig. 9, R. 563-64; R. 222b-c, 223-24).

(b) *Settling overdrafts through overdrafts.* It was subsequently disclosed that on every pay day for the HHM plant during the entire month of May 1959, HHM's regular payroll account in its principal depository had payroll ovedrafts outstanding against it. That is, the balance on hand was not sufficient to cover the checks issued to the plant workers by way of payroll. These payroll overdrafts ranged in amounts from $24,466.29 to $54,297.52. During at least half of the month, overdrafts on the regular payroll account were subsequently reimbursed by overdrafts on the

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in his bank, which would be the first possible date at which it might acquire a bank date stamp. When the checks at any given time which had been issued and sent to creditors but which had not yet received a bank dating stamp are taken into account, it is apparent that the overdraft figures for HHM would be even larger, and the total number of days on which it was overdrawn quite likely greater. This is the reason why the independent auditors who prepared the overdraft figures would not certify to the figures as exact, but simply stated that the amounts of checks outstanding totaled "at least the amounts reflected in the reconciliations and produce[d] overdrafts at least in the amounts shown on the Report of December 8, 1960" (R. 551-52).

[8] We make this computation only for the purposes of illustration; the proper accounting usage is even more severe. Generally, an overdraft in one bank should be considered to be not simply an offset to cash balances elsewhere, but a current liability. See Kennedy, Financial Statements (1947), p. 30.

company's general account in the same bank. During this period the general account itself had overdrafts outstanding against it in amounts ranging up to $116,809.86. Moreover, during this period the HHM accounts in all banks had net overdrafts outstanding against them in substantial amounts—as high as $79,037.17 (Fdg. 10, R. 564; R. 222c, 233).

(c) *Creation of fictitious balances through multiple deposits and withdrawals.* The following extraordinary transaction was repeated on numerous distinct occasions. On January 30, 1959, HHM drew a check for $34,000 on its account at the Wells Fargo Bank of San Francisco. This check was deposited in HHM's account in the Irving Trust Company of New York City. On the same day a check for the same amount was drawn against the Irving Trust and deposited in HHM's account at People's First National Bank & Trust Company of Pittsburgh. Again on the same date, a check for the same amount was drawn on People's for deposit in HHM's account in The First National Bank and Trust Company of Hamilton, Ohio.

Thus, by the simultaneous transfer and re-transfer of a single $34,000 deposit, on February 2, 1959, HHM was able to create a total aggregate balance of $136,000 in these four banks scattered across the North American continent. The same method of operation, which bears striking resemblances to what is popularly called "kiting", was followed by HHM on six other occasions in the first half of 1959, always involving the same four banks. On these seven occasions, a total aggregate balance of $617,500 was created by this procedure. There were other transactions involving artificial balances created by "float" in which fewer banks were involved (Fdg. 13, R. 565; R. 554-55).

(d) *Heavy use of demand loans.* During the period in question, HHM borrowed money on a demand note basis from its principal bank depository in Hamilton, Ohio. The notes never had a fixed term, but were all subject to the arbitrary call of the bank. The bank was limited by law to making loans not in excess of $300,000 to any one customer. During 1959, HHM's demand notes never fell below $250,000, and on two occasions the amount was raised to the legal limit. HHM's bank "kind of shunned demand notes" and did not wish to carry this particular loan at the legal limit except on a temporary basis. The bank president testified that if the bank had called on HHM to pay off the demand notes, he did not know whether HHM could have obtained the money to do so; indeed, he gave it as his belief that, in fact, HHM could not have obtained the money elsewhere to do so (Fdg. 14, R. 565; R. 456-57; 460-61, 468, 470-71).

(e) *The "black box".* Another interesting but hardly orthodox source of financing by HHM during the period in question was its device of preparing and dating checks for its trade creditors at the time that their invoices were approved, but of not releasing the checks until later. In the meantime, they were kept by HHM in what was called the "black box" (R. 579). As a result of this practice a lapse of between 30 and 120 days between the preparation of a check and its issuance and cancellation by the bank was not unusual. In the period of 1959 before the acquisition, at least 100 HHM checks per month cleared the bank in excess of 30 days after the date of the check (Fdg. 18, R. 566; R. 556).

An interesting example of the operation of the "black box" appears in HHM's dealings with Alcoa.

HHM's Treasurer, in person and in correspondence, in December 1958 had solicited Alcoa to extend HHM 90-day credit terms, but Alcoa had declined HHM's request that its "30 days net" credit terms be thus extended. HHM then proceeded, notwithstanding Alcoa's refusal, to effect the extension itself by putting Alcoa's checks in the "black box" and holding them up for periods of close to 90 days (Fdg. 18, R. 566; R. 558-560, 429-430).

It should be noted, in the light of the repeated erroneous statement to the contrary in the Government Brief (pp. 13-14, 41), that these prepared but unissued checks are *not* included in the figures for HHM's overdrafts, and are separate and distinct therefrom. The overdrafts reflected by the Lybrand, Ross audits take into account only checks that were "floated" out of the black box and which had received a first cancellation stamp by a clearing bank. Lybrand, Ross could not certify as to checks in "float" which had not yet cleared a bank and consequently had not yet received a bank cancellation—the only hallmark Lybrand, Ross could rely on to determine beyond question that an HHM check had been in circulation on a date certain. Thus, the Lybrand, Ross reports reflected the *minimum* checks in "float" at any given moment. See note 7, p. 12, *supra;* R. 551-52, 585-86.

9. *HHM's position at the time of the closing.*—By the time of the closing on September 11, 1959, HHM had incurred operating losses for the fiscal year 1960, which had commenced on July 1, 1959, in the amount of $206,953.51 (Fdg. 16, R. 566; R. 222b). As stated, at an annual rate these losses would have exceeded $1,000,000. Furthermore, by the time of the closing, HHM's net

quick asset ratio had declined to .03—its cash and Government securities were equivalent to only 3 percent of its current liabilities (Fdg. 6, R. 563; R. 557). It had a nominal bank balance on the books of its principal depository of $13.92 at the start of September—and even then its checks in the amount of $113,000 were in the hands of its creditors. At the closing, which was in the form of a sale of assets, HHM declined to present a check to Diebold in settlement of its principal bank account on the ground that the account was actually overdrawn on account of outstanding checks. The overdraft on account of outstanding checks on this account as of the day before closing, September 10, was $53,978.59. If, against this deficit, there be credited HHM's smaller positive balances in other banks,[9] HHM on the day before closing had a net overall *deficit* in its bank accounts in the amount of $35,596.61 (Fdgs. 3 and 9, R. 562-64; R. 222b, 231).

As of the closing, HHM had accumulated past-due trade bills, payable dating back prior to January 1959, in the amount of $244,127.68. In addition to these past-due bills, at the closing HHM also had currently due trade bills payable in the amount of $499,833.66 (Fdg. 17, R. 566; R. 222b, 235). This was in the face of a net overdraft position in respect of all its bank accounts. Upon acquiring HHM, in the light of HHM's inability to deliver a check for its principal bank account, and its overdrawn cash position, Diebold immediately commenced advancing cash to HHM. Within the next three weeks it had advanced a total of $500,000 to meet current and past-due obligations of HHM (Fdg. 19, R. 566-67; R. 235). Further cash advances had to be made in later months (R. 265).

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[9] See note 8, p. 13, *supra*.

10. *Disclosures after the closing.*—In the period after the acquisition, the facts concerning HHM's desperate financial condition began to come to light. Diebold then caused audits to be made of HHM's finances, and an operations survey to be made by independent management consultants. This survey by the independent management consultants, proposed in October 1959, and commenced in December of that year, indicated poor supervisory methods, unsound and obsolete design of tooling equipment, and lack of currently-accepted practices of inventory management, production control, and quality control. It found a picture of unsatisfactory labor application and of inflated performance reports, rendered under the prior management, which gave a false picture of the efficiency of the labor application. The report commented that "the manufacturing personnel had been long dominated by a strong-willed individual with an extremely limited manufacturing background" (R. 261). The report's conclusion was that "from a manufacturing standpoint, Herring-Hall-Marvin Safe Company was very poorly organized and operated. It was clearly a high-cost producer and could succeed only as a marginal operation . . . It would be hard pressed to survive under close pricing conditions or in a highly competitive market" (R. 261-62; see Fdg. 21, R. 567-68).

11. *Continued decline in business and continued cash needs.*—After the acquisition the pattern of losses continued, although, of course, now covered by Diebold's cash advances. Operations of the HHM Division of Diebold continued to reflect losses through the first seven months of 1960. These losses culminated in a loss of $106,000 for the month of July 1960. In the eight months ending August 31, 1960, new orders en-

tered by the HHM division declined $2,307,707, or 29.8 percent, from the same eight-month period in 1959. During this period the HHM Division's shipments exceeded its new orders by $449,000. By July 31, 1960, Diebold's cash advances to the HHM Division stood at $840,000, despite the shrinkage of the business (Fdgs. 19, 23, and 24, R. 566-68; R. 264-65).

B. The Government's Proofs With Respect to HHM's Financial Condition

The primary proofs submitted by the Government on the issue of HHM's financial condition were the affidavits of two employees of the Department of Justice. Exhibited to the affidavits, or forming their factual basis, were various undisputed items of public record or in official files, relating to HHM and to other corporations. Furthermore, to a considerable extent these affidavits used as their basic material the proofs filed by Diebold, including the audit reports of the independent public accountants which Diebold had filed.—The affidavits filed by the Government do not reflect any firsthand acquaintance with the company's books and records on the part of the affiants. They were of such a nature as could have been prepared at their authors' desks in Washington.

1. *The Singman Affidavit.*—The first affidavit was one by Milton Singman, an FBI agent and accountant. It recited that it was based upon HHM's published financial statements (which the District Court later found "failed completely to reflect the actually insolvent condition of the company") and upon the independent auditors' special reports filed by Diebold in support of its Motion. The affidavit simply swore to various matters of records, mainly relating to HHM's so-called long-term position, and not related to the

crucial issue of its internal cash condition in 1959, prior to the closing.

Specifically, the affidavit swore to the published earnings figures down through June 30, 1959, which indicated that HHM was showing a profit; to the published figures showing a growth in its retained earnings account (an accounting charge account rather than an asset account, it will be noted);[10] to the annual dividends of less than $12,000 which had been paid throughout the late '50s, and to the book value of the stock; to the company's working capital position, expressed in terms of a ratio which included inventories on an equal footing with cash;[11] and to the company's dwin-

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[10] "Retained earnings" is simply one of the elements on the liability side of the balance sheet, such as actual liabilities, capital, and capital surplus. It of course does not represent any definite assets—which, in the final analysis, must be used to pay bills and meet the payroll.

[11] Even the other Government affiant recognized that such a ratio was not satisfactory. See Neisser affidavit, ¶ 15 (unprinted portion).

The indiscretion of using ratios taking HHM's inventory into account in the 1959 crisis is confirmed by standard treatises on accounting: "A business with a high current ratio might not be in a position to pay current liabilities because of an unfavorable distribution of current assets relating to liquidity. For example, the merchandise inventory may be excessively high in relation to prospective sales; an increase in inventory accompanied by a decrease in sales and accounts receivable may represent an unwarranted accumulation of inventory . . . . An increase in notes payable accompanied by a decrease in business volume may reflect the inability of a company to pay its accounts payable when due, and therefore establish a need for additional working capital." Kennedy, Financial Statements (1947), p. 208.

"In many lines of business, a concern whose current assets consist largely of inventory can very easily become technically, if not actually, insolvent within an incredibly short period of time." Guthmann, Analysis of Financial Statements (1953), p. 109.

dling long-term debt position, without discussion of the demand note character of its debt during the crucial period (R. 331). None of these items threw any light on the company's liquidity position during 1959 which was, of course, the crucial issue in the case.

The affidavit also called attention to the fact that HHM's ratio of expenses to sales was similar, as of June 1959, to that of June 1950, without alluding to the fact that, as discussed by the very reports upon which the affiant relied, HHM's expense ratios had, by 1959, built up severely in the short swing. (Taking fiscal 1957, a year of somewhat larger sales, as a base, the Selling, General and Administrative Expense Ratio, as a percentage of sales, had risen from 17.6 percent to 20.2 percent in fiscal 1959.) (R. 332, 337). The affidavit also compared, on a general basis, average working capital ratios for the late '40s with those of the '50s, lumping together the entire period of 1950 through 1959 without particular focus upon the liquidity situation in 1959 (R. 332).[12] Likewise, the affidavit compared the rate of inventory turnover during the entire period of the '50s with that prevalent during the late '40s, again without calling attention to the fact that, as revealed by the figures on which the affidavit was based, the company's rate of inventory turnover in 1959 had been slowing down steadily for the cycle commencing in 1956 (R. 332, 342). (In 1956, inventory had turned over 6.21 times per year, while by 1958 the figure was down to 5.75 times per year, and in the critical year, 1959, it had dropped to 4.75 times per year.) (R. 342)

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[12] The ratios used again equated inventories with cash. See the comment in note 11, p. 20, *supra*.

In short, the Singman affidavit simply swore to various undisputed facts dealing with the profit and retained earnings accounts as revealed by HHM's published figures, and made certain comparisons in the gross between HHM's performance in the entire period of the post-war '40s on the one hand, and in the entire period of the '50s on the other.[13] It made no effort to focus on the specific issue in the case, which related to the current position of HHM during 1959, despite the fact that part of the underlying figures on which it was based—the special audit reports made from HHM's internal papers—permitted such an analysis. Of course, these figures confirmed the picture of HHM's liquidity plight in 1959.

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[13] Besides those mentioned, Singman drew decade-wide comparisons for the 40's and 50's in respect of current-liability-to-cash-and-receivable ratios, and in respect of the earned surplus account. (See note 10, p. 20, *supra*). (R. 332). He also compared HHM's earnings for its last profitable year with those of other companies in the fabricated metal products industry (R. 333).

Furthermore, through the time-honored device of carefully selecting a base year, the Singman affidavit developed some ratios which are not only *not* representative of HHM's performance but, indeed, grossly conceal HHM's financial deterioration. One example is the Government's assertion that during the period from 1950-59, the ratio of the company's cost of sales and selling and administrative expense to net sales remained about the same (Gov. Br. 11). But Singman's own affidavit makes it clear that net operating profit was down, on an average for the two periods from 7.5% to 4.7%. And, to come to the point of specific relevance to the case, the net operating profit figure had fallen to under 4% in fiscal '59; of course, after the close of fiscal '59, operating losses commenced.

Another example of a dubious use of a base year is presented by the Government's assertion of an increase in HHM's net sales ratio from 1.29 to 4.73 between 1955 and 1959 (Gov. Br. 15). This, as the Neisser affidavit makes clear, is a comparison made by selecting one of HHM's worst years as a base year. If a more representative year, 1956, is taken as a base year, HHM's ratio declined from 6.79 to 4.73 (See R. 337, Neisser affidavit, Table 1 (unprinted portion).)

2. *The Neisser Affidavit.*—The Government also filed an affidavit of Albert Neisser, a business economist in the Antitrurt Division, who was associated in the case with counsel for the Government (R. 599-600). The Neisser affidavit was based upon the Federal income tax returns filed by HHM, by Diebold, and by the Mosler Safe Company, upon certain census reports, and upon certain reports of Dun & Bradstreet, Inc.

Neisser's affidavit, like Singman's, concentrated on a "long view" of the matter, not concerning itself with the details as how HHM could have survived during 1959. Neisser swore to various "conclusions"; one of these conclusions to which he swore was that "before the merger, HHM was in a sound financial condition." (R. 600) No details were provided by the affiant as to how much less than an over-all *negative* bank balance of $35,596.61 a company would have to have before it would be considered to be in an unsound financial condition. Some of the other "conclusions" of the affidavit were (a) that HHM "had had a profitable financial history during the five years preceding the merger" (R. 600)—a conclusion which referred simply to its published profit and loss and balance sheet figures; (b) that "its balance sheet as of June 30, 1959, showed it to be free of long-term debt" (R. 600)—as opposed to short-term demand debt which, unlike long-term debt, was specifically relevant to its current position in 1959; and (c) that "a number of tests applied customarily by accountants and economists revealed that the company had been operated with effective use of its financial resources" (R. 600)—that is, as long as the company made a profit, because of its short working capital position, its ratio of profitability to working capital appeared most impressive, or as the affiant more elegantly

expressed it, HHM had a "capacity for making limited means go a long way." (Neisser aff. ¶ 20 (unprinted portion)).[14]

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[14] The references to the Neisser affidavit by paragraphs are to the unprinted portions of it. (See Gov. Br. 14, n. 10).

Other aspects of the Neisser affidavit indicate a similar approach—that is, a comparative, "long-term" analysis which attempted to show HHM as efficient on the basis that, inasmuch as its working capital was so short, its performance expressed *in terms of a relationship to its working capital*, or related figures, seemed favorable as long as any profit was being shown. The comparisons were on the basis of the five-year period running for HHM, from July 1, 1954 to June 30, 1959.

For example, Neisser dwelt on a so-called favorable ratio of HHM's profits to its *investment in its business*, as compared to that of Diebold and Mosler Safe Company (Paras. 12 and 13). Again, he compared HHM's profits *in relation to its working capital* with those of Diebold and Mosler (Paras. 17 and 18), concluding, understandably enough, that "this comparison of HHM with Diebold and Mosler shows HHM in a very favorable light" (Para. 17). Another comparison infected by the same fallacy was that between HHM's *ratio* of net sales *to net working capital*, and those of Diebold and Mosler (Para. 20).

Similarly, Neisser noted that HHM made "more use of" its current assets than Diebold and Mosler.—This is a euphemistic expression of the fact that its current assets were considerably less in relation to its net sales than were those of Mosler and Diebold (Para. 25).

The one thing in common which these various comparisons used by Neisser have is this. They all are ratios which tend to make a company with a weak working capital position, which is nonetheless showing some profit, appear in a favorable light. They are, accordingly, "fair weather" ratios; but they do not address themselves at all to the problems which HHM had in 1959, about which this case turns. Indeed, a company which performs favorably on the basis of such ratios may, as HHM was, be precisely the sort of company which is unable to weather a financial crisis. Thus, not only do the Neisser comparisons not contradict the fact of HHM's financial crisis in 1959, they in fact suggest the background for that crisis.

Neisser admitted that HHM did not meet the common rule-of-thumb that a company have $1 of current assets (excluding in-

The Neisser affidavit's only discussion of the current position of HHM is simply a critique of Diebold's method of the comparison of HHM's ratios with those of other companies.[15] (R. 602-03). But, in any event, the affidavit pointed to no group of companies in which the net quick asset ratio was nearly as low as 7 percent —HHM's June 1959 figure—let alone 3 percent—HHM's figure at the time of the closing. The Government economist swore further that "similarly, a company that can count among its main customers the Federal Government,[16] the nation's banks, and substantial credit institutions, may well be justified in considering a larger portion of their receivables as liquid

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ventories and prepaid expenses and supplies) for each $1 of current liabilities (Para. 16). As usual, he sought to make a virtue of HHM's thin position by pointing to the high ratio of sales and earnings *in comparison to its working capital* (Para. 17).

Neisser's position on the current ratios of HHM was that HHM should not be compared with any companies other than those "well known for their production of safes and vaults" (R. 602). In line with the Government's theories as to the market in this case, these other companies included, in Neisser's presentation, only Diebold and Mosler. Of course, the figures compared were not restricted to the safe and vault-making functions of each company. In any event, HHM's ratios were grossly inferior to those of Diebold and Mosler as shown by Neisser's own tables. See Tables 5 & 6.

[15] The affiant quarreled with Diebold's inclusion of HHM in the category of a manufacturer of "Other Fabricated Metal Products" (in the classification used in the FTC-SEC "Quarterly Financial Reports for Manufacturing Corporations") (R. 601-03). Yet the other Government affiant used this category for a comparison of HHM. See R. 333. It is clearly an appropriate category. See note 4, p. 9, *supra*.

[16] Neisser's academic speculation that the Federal Government was not "slow pay" does not appear to be borne out by the record of the case. HHM seemed to have particular trouble with its receivables on a type of file manufactured primarily for the Government (R. 360, 558).

assets than a company with large numbers of small firms as customers'"[17] (R. 603). But the affiant did not offer any information as to whether, even in the case of a company so favored, it might not be advisable to have a little more than $13.92 as a bank balance per statement, and to have a somewhat better real cash position than a net overdraft of $35,596.61—HHM's overall position at the time of the closing.

The Neisser affidavit made further general comparisons not specifically related to the critical period between the operating performance of HHM and of Diebold and Mosler through the years.[18] It also referred to a favorable credit rating given HHM by Dun & Bradstreet in March 1959. (R. 602) However, the record did not show that Dun & Bradstreet were privy to the facts disclosed to the District Court, such as, for example, that in March 1959 HHM's critical lack of

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[17] The affiant did not address himself to the question whether it might not be advisable for a company seeking to do business with "the nation's banks" to maintain accounts at a number of them, thereby increasing rather than decreasing its cash requirements. HHM maintained accounts at a number of banks outside of its principal depositary (R. 554-55).

[18] A sample of these comparisons is given in note 14, pp. 24-25, *supra*.

It would have been more meaningful if Neisser had set forth the ratio of gross profit per dollar of sales, a critically important ratio in predicting an enterprise's ability to continue in business. During the period '55 to '59, HHM showed an average gross profit of 31 cents per dollar of sales. During the comparable period, both Diebold and Mosler averaged more than 40 cents gross profit per dollar of sales. Thus, HHM's profit per dollar of sales was 25% less than the companies the Government chose for comparison (R. 599, Neisser affidavit, Exhibits 1-15 (unprinted portion)). This low margin of gross profit clearly indicates that a very small increase in costs could completely wipe out any HHM profits and indeed cause a loss. This is precisely what happened in the summer of 1959.

funds forced it to hold up payment of such substantial accounts as Alcoa for periods ranging up to 90 days (R. 556); and the other revelations made after the closing.

C. The So-Called Alternative Purchasers

The Government claims that there were three non-competing prospective purchasers who were interested in acquiring the business of HHM. The record reveals the following as to them:

1. *Colonel T. C. Davis.*—One Van Ness, an Assistant Treasurer of the Bank of New York, in the spring of 1959 heard through a contact man at Ebasco Services, Inc., that a certain Colonel T. C. Davis "had a continuing interest in attractive investment opportunities" and that he "might have some possible interest in trying to arrange an exchange of HHM stock for that of some company in which Colonel Davis had a present interest." (R. 284) After a phone call to Colonel Davis[19] in which "Colonel Davis indicated he had little knowledge of the HHM Company but that he was always willing to explore an investment possibility", Van Ness wrote Mosman. (R. 284) Van Ness' letter to Mosman purported to be written on behalf of "a group of people with whom we are well acquainted and who are interested in making constructive investments", who had "requested" Van Ness to make inquiries on their behalf. After a few contacts with Mosman, and after informing Mosman that he could not predict whether

[19] The Government refers to Colonel Davis as a "Director of the American Chain & Cable Company" (Gov. Br. 33). Apparently he was, but the record does not support any implication that his contacts with Mosman were on behalf of that company. Neither does the record indicate that VanNess' promotional activities were on behalf of the bank rather than in search of a personal finder's fee for himself.

negotiations with Davis held any promise, Van Ness secured an expression of willingness from Mosman to meet Davis (R. 288). Mosman put off meeting Davis until "after we had closed our books as of June 30, 1959"; his last letter to Davis stated that "we are still in the process of closing our books" (R. 299). Colonel Davis evidently went on a European trip, and no meeting between Davis and Mosman, with its prospects of a request of a disclosure of HHM's books, ever occurred. It does not appear that Davis ever sought any information at all from Mosman in respect to HHM, and notably, no "financial data or operating figures [were] ever supplied to Colonel Davis by Mr. Mosman" (R. 285).

2. *James H. Boyce.*—Mr. Boyce operated out of Baton Rouge, Louisiana, and was connected with various enterprises such as a Baton Rouge machinery sales and service company, a local Ford dealership, and an automobile leasing company. In or about 1958 Boyce became interested in the manufacture and sale of a burglar alarm device (R. 345). Boyce contacted Mosman in the middle of 1958, saw his plant in August, 1958, and had sporadic contact with him for some time in 1959. In all this period Boyce states that "a definite offer was never made" by him for the acquisition of HHM (R. 345).

Boyce's Washington attorney, Cross, sought to promote a deal for HHM by soliciting Hayden, Stone & Co., New York investment bankers, submitting to them a pamphlet outlining a scheme for financing the deal (R. 347). The bulk of the attorney's covering letter was devoted to a discussion of the middleman's fee to be anticipated in such a deal. (R. 347) It also disclosed an attempt to interest, as a possible purchaser,

a Mr. John A. Coakley of the Automatic Sprinkler Corporation of Youngstown, Ohio. The letter requested that, if the pamphlet were presented to Mr. Coakley, "please specifically point out that I have distinctly emphasized the Boyce interest as a matter of psychology" (R. 347-49).

The pamphlet that the prospective middleman had prepared was replete with estimates of projections of HHM's future earnings through 1968 (R. 351-55), although Mosman had never made any disclosure of the real condition of HHM's finances to Boyce or his promoter who prepared it. The solicitation stated that "it should be distinctly understood the following in no way constitutes an offer, but rather a basis for discussion". (R. 348) The pamphlet envisioned that the purchase would be made by a "purchasing group"—not yet formed—and there might then be a flotation of stock to the public (R. 349). The pamphlet stressed that "all items, such as past profits, value of equipment, etc., are subject to verification" and that "the purchaser must have an opportunity and sufficient time for necessary verifications". However, Mosman never opened his books to Boyce or any of his promoters (R. 348-49).

The pamphlet was never brought to Mosman's attention, but Boyce orally mentioned, in discussions which never ripened into an offer and which never brought forth any disclosure on Mosman's part, a plan contemplating debt financing in the sum of $1,500,000, or a long-term lease of HHM's fixed assets and outright acquisition only of the remainder of the business (R. 270, 346).

The memoranda and other documents reflecting the promoters' plans for the deal inevitably contemplated

and required direct bank financing or public stock financing of the transaction, with the concomitant revelations of HHM's condition which such forms of financing would entail. There was no evidence of what effect an accurate disclosure of HHM's condition would have had upon Boyce, upon the "purchasing group" the pamphlet contemplated, upon readers of the prospectus required in a public offering as contemplated, or upon a prospective debt financier of the deal. (R. 345-56, 270-71).

3. *Lovell Manufacturing Company.*—Lovell Manufacturing Company of Erie, Pennsylvania, deals in clothes-wringers and dryers. Representatives of Lovell and HHM had a meeting in April, 1959, at which Mosman mentioned the figure of $3 million in cash. Lovell stated that they were not interested under such circumstances. After the meeting, Lovell wrote HHM: "You can expect to hear further from us within the next few weeks regarding some preliminary ideas concerning the matters which we discussed." Nothing of significance, including even any revelation of the "preliminary ideas", seems to have ensued (R. 270, 272-74).

* * *

The District Court found that these three interests (Van Ness-Davis; Cross-Boyce, et al.; and Lovell) were but "promoters" who made no actual offer for HHM. It further found that HHM's condition dictated that it make a quick sale without exhaustive analysis of its books and records, and that Diebold was the only bona fide prospective purchaser (Fdgs. 29, 30; R. 569).

D. The Parties' Conduct as Reflecting Upon the Financial Condition of HHM

This section reviews the record in respect of the Government's repeated insinuation that the raising of the failing company issue was some sort of afterthought. (Gov. Br. 4, 6, 17-18). With one exception,[20] Diebold, at the time of the closing, did not know the specific facts concerning HHM's desperate financial condition (R. 11; 222a-e, 262-63). The District Court so found (Fdg. 16, 17, 18, 21, 29; R. 566-69). While Diebold was shown an inaccurate (even as orally amended) interim balance sheet for April 30, 1959, it received no further figures from Mosman. Thus, Diebold was ignorant of the interesting practices with respect to the making up of HHM's earnings' statements and balance sheets; of the details of HHM's working capital position; of the commencement of heavy operating losses on the part of HHM; of the "black box" procedure for misdating checks and egregiously slow payment of HHM's trade accounts; of the habitual overdraft condition of HHM; and of the creation of fictitious balances through account transfers. Nor did Diebold have any indication of the further deterioration in HHM's condition that had set in during the summer of 1959, when actual operating losses commenced.

During the summer of 1959, Mosman was engaged in attempting to obtain a renegotiation of the contract to obtain slightly better terms of sale, including terms

[20] The exception is simply that in May 1959 Mosman told Diebold that on the uncertified HHM April 30, 1959 interim balance sheet, he had reclassified $100,000 of receivables as cash (R. 222a). As the Statement of Facts makes plain, this was hardly even Chapter One in a complete financial story of HHM, and it was very far from being exhaustive of even the misstatements inherent in the April 30 balance sheet. See R. 222a-e.

particularly favorable to him to the exclusion of the minority shareholders of HHM. Diebold, upon Mosman's threat to break the contract, reluctantly acceded to his demands, which increased the purchase price by a small fraction of one percent[21] (R. 10-11).

The Complaint and Motion for Preliminary Injunction were filed in August 1959, before the closing of the sale. The Preliminary Injunction Motion was opposed in early September 1959, also before the closing. As the Government points out, in his affidavit and deposition taken before the closing, Mosman, the seller, made no reference to the dire financial condition of HHM, the property he was selling. Neither did Diebold then allude to HHM's financial condition for the simple reason, as the District Court later found, that it did not then possess any particular information in regard to it.[22]

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[21] The only extra consideration which came to have an actual cost was the payment of certain personal expenses of Mosman, in the context of a $3,000,000 acquisition (R. 10-11).

[22] The Government makes some point of the fact that in its Answer, filed five days after the closing, Diebold made no reference to the financial condition of HHM. But the record is clear that the full picture of HHM's true condition was not one which could be learned in a matter of days. Moreover, and more pertinently, Diebold's Answer (R. 158-59) was a short-form answer essentially in the form of a general denial of the material allegations of the Complaint; the Government does not suggest that the "failing company" issue is a matter that must be raised as an affirmative defense in the Answer.

It was only upon the discovery of such internal working papers as Mosman's Treasurer's worksheets for the management of his overdrafts (R. 468-70) that Diebold became fully aware of what had been happening.

These papers were discovered and copies furnished to the Government in the early part of 1960 (R. 202, 207). The failing company issue in this case thus considerably antedated the date at which the Government places it (Gov. Br. 5-6).

In short, Mosman did not publicly advertise HHM as a failing company. Neither did, we hasten to add, Diebold purchase it on the basis that it was. HHM was, however, as later examination revealed to Diebold's regret, as the proofs submitted on the Motion for Summary Judgment unquestionably made out, and as the District Court found, *in fact*, a failing company at the time of its acquisition by Diebold.

SUMMARY OF ARGUMENT

I.

A. HHM was so hopelessly insolvent at the time of its acquisition by Diebold that its acquisition could not be considered prejudicial to the public or as substantially lessening competition. Thus, under the rule of *International Shoe Co.* v. *FTC*, 280 U.S. 291 (1930), the acquisition could not be deemed to violate § 7 of the Clayton Act. The rule of the *International Shoe* case applies to companies which find themselves in a failing condition on account of rapid deterioration of their current liquidity positions, as well as those which suffer from long-term declines.

B. Congress ratified the *International Shoe* doctrine in enacting the 1950 revision of § 7, and it made it plain that the doctrine's application was broader than simply to cases of technical bankruptcy. The doctrine has been consistently applied by the courts and in the practical administration of the antitrust laws, and its soundness is not questioned by the Government in this case.

C. HHM was in a current crisis of such a nature throughout 1959 as to bring it within the *International Shoe* doctrine. A shrinkage of sales, coupled with an increase of costs commencing in 1957, taken with its

continually thin working capital position, had weakened it financially. Its condition worsened tremendously in 1959, with the signing of an unfavorable union contract and with the commencement of actual operating losses. Its book figures and statements had for years not reflected its actual condition, and practices of a bizarre nature were adopted in 1959. The company was chronically overdrawn, even on its payroll account. It engaged in transactions to create fictitious bank balances. It used a "black box" procedure to delay its creditors. Its cash sunk to 3 percent of its current liabilities. It accumulated heavy overdue bills and was heavily indebted to its bank on a demand-note basis. By the time of the acquisition, it was obvious that HHM never could have worked itself out of its current position, and its subsequent history underscores the fact that a further deterioration, which would have been fatal, was about to ensue.

The Government's proofs on the question of HHM's financial condition do not touch the specifics of its massive failure of liquidity in 1959. They went largely to its "long-term" condition—that is, based on HHM's published figures, they expressed what its prospects would be in the long-run, assuming that nothing happened in the short-run that prevented the company's survival. This presentation was simply irrelevant to the basic issue in the case—the question of HHM's survival in 1959.

II.

There were no parties other than Diebold who offered realistic, live alternatives to the sale that was in fact effected. The individuals whom the Government points to in this respect are will-of-the-wisps, heavily involved

with promoters and middlemen, none of whom ever considered himself to have made a definite offer for HHM. At the least, their contacts with HHM were slight, and at the most, desultory. None of the figures in question were afforded access to HHM's internal books; clearly, none would have been interested in HHM if they had; yet none expressed an interest in buying without financial verifications. As a practical matter, none of these figures was a real alternative purchaser for HHM under the circumstances. There was no alternative, other than liquidation, to the sale of HHM to Diebold.

III.

The use of summary judgment was appropriate in this case where, after extensive discovery had been had by the Government, the issues turned on financial data as easily established on a summary judgment motion as through an identifying witness. The narrow issue determined by the Court under § 7 did not pose questions of conspiracy or intent, but simply an issue of a nature as to which this Court has approved summary judgment in civil antitrust litigation. The record is devoid of a genuine conflict as to a material fact. At issue are matters solely of conclusion from the record. The record as to one issue of intent as to which the Government now claims a conflict, is in fact free therefrom; and the "issue" was never raised before the appeal to this Court. The record, accordingly, was ripe for a summary judgment on the "failing company" issue, which obviated time-consuming further discovery, and obviated an unnecessary lengthy trial on the tangled issues of the relevant line of commerce and of the general effect of the acquisition upon competition.

ARGUMENT

I. HHM WAS WITHIN THE INTERNATIONAL SHOE DOCTRINE AT THE TIME OF ITS ACQUISITION BY DIEBOLD

A. *The International Shoe doctrine.*—In *International Shoe Co.* v. *FTC,* 280 U.S. 291 (1930), the Supreme Court, reversing an FTC finding of a violation of § 7, enunciated the following very practical doctrine:

> "In the light of the case thus disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act. To regard such a transaction as a violation of law . . . would 'seem a distempered view of purchase and result.' " (280 U.S., at 302-03.)

This principle has ever since been styled the "failing company" doctrine. The establishment, on the facts of a given case, that the acquired firm was a "failing company", avoids a charge that its acquisition violates § 7 of the Clayton Act.

The facts of the *International Shoe* case indicate a type of failing condition which has a substantial similarity to the facts at bar. The failing company in the *International Shoe* case, the McElwane Company, was

not sold under judicial process or with any loss to its creditors. Rather, as here, its purchaser assumed its business liabilities which were then, so far as the record indicates, paid in full. Over and above this, there, as here, some consideration was paid the seller in respect of the equity in the business on account of the company's long-term prospects—the acquiring company in *International Shoe* gave its own stock in the market value of $9,460,000 for the stock of McElwane Company. The precise aspect in which McElwane was found to be a failing company was in regard to its current position—"the company had reached the point where it could no longer pay its debts as they became due",[23] 280 U.S., at 300. The McElwane Company's current position in the years in question—the depressed shoe business of 1920-21—was (despite its "long-term" prospects) the specific aspect in which this Court found it to be a failing company.

B. *Ratification of the International Shoe doctrine in the Amended* § 7.—While the *International Shoe* decision was rendered under the original § 7 of the Clayton Act, the legislative history of the 1950 revision of § 7 makes it perfectly plain that Congress intended the doctrine to be available on the same terms under the Act as amended. The Senate Report declares:

> "*Companies in a failing or bankrupt condition:*
>
> "The argument has been made that the proposed bill, if passed, would have the effect of preventing

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[23] It might be noted, apropos of the Government's overly strict statement of the failing company standard, that in *International Shoe* there had not even been a complete cessation of dividends on the part of the acquired company. See 280 U.S., at 300. It should be noted that the Government repeatedly chooses to mention the fact that, up to and including the fiscal year commencing July 1, 1958, HHM continued to pay a quarterly dividend amounting to an annual amount of less than $12,000 (Gov. Br. 11-12).

a company which is in a *failing* or bankrupt condition from selling out.

"The committee are in full accord with the proposition that any firm in such a condition should be free to dispose of its stock or assets. The committee, however, do not believe that the proposed bill will prevent sales of this type.

"The judicial interpretation on this point goes back many years and is abundantly clear. According to decisions of the Supreme Court, the Clayton Act does not apply in bankruptcy or receivership cases. Moreover, the Court has held, with respect to this specific section, that *a company does not have to be actually in a state of bankruptcy to be exempt from its provisions; it is sufficient that it is heading in that direction with the probability that bankruptcy will ensue.*" (Quoting from *International Shoe*) (Sen. Rep. No. 1775, 81st Cong., 2d Sess. (1950), p. 7, emphasis supplied.)

And the House Report:

"The argument that a corporation in bankrupt or *failing* condition might not be allowed to sell to *a competitor* has already been disposed of by the courts. It is well settled that the Clayton Act does not apply in bankruptcy or receivership cases. *In the . . . [International Shoe* case] *the Supreme Court went much further . . .*" (quoting) (H.R. Rep. No. 1191, 81st Cong., 1st Sess. (1949), p. 6, emphasis supplied).

This legislative history makes it plain that the doctrine is not simply one that applies in conditions of actual bankruptcy or insolvency: "It is sufficient that (the acquired company) is heading in that direction with the probability that bankruptcy will ensue." (Sen. Rep. No. 1175, *supra.*) However, it is apparent from the record that HHM's condition was, by the

time of the acquisition, one of strict insolvency—lack of ability to pay its debts in due course;—and that even the overly-strict verbalization of the doctrine found in the Government's Brief (pp. 22-23, 25-26), would apply to it. Nevertheless, although the point is hardly necessary for decision here, we think the quoted legislative history clearly indicates a broader scope for the doctrine than suggested by the Government, and that this legislative mood of Congress should be taken into account in any statement of the law on the subject. Cf. *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 487 (1951).[24]

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[24] The Government weakly suggests (Gov. Br. 22, n. 12) that the "failing company" doctrine may not be available where the complaint includes a charge that an acquisition tends "to create a monopoly." The short answer is that the legislative history of the amended Section 7 is unqualified as to the general availability of the doctrine. Moreover, essentially the same logical reasons that gave rise to the enunciation of the doctrine in the *International Shoe* case would support it even if the charge were that of a tendency to create a monopoly. *Cf.* Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226, 340 (1960).

The Government's implication (Gov. Br. 22) that there is a monopoly issue presented by the facts of the present case, is of course a result of its continued fallacious approach to the definition of the market here. Both Diebold and HHM are basically fabricators of steel engaged in the manufacture and processing of a diverse line of metal equipment (R. 15-20). There are innumerable competitors of Diebold and HHM (R. 16-25). In fact, the definition of "relevant market" is a question of bewildering complexity here. Bank equipment is largely indistinguishable from office equipment generally, and the largest companies in the field, such as Sperry Rand and Shaw-Walker, manufacture a general line of safes and office equipment used by banks. An equally large portion of Diebold's annual business is general office equipment designed alike for insurance companies, municipal offices, factory offices and banks (R. 15-25, 123-25, 128-29, 137-40, 527, 539-40). Government counsel admitted that "It's not a one-

The basic doctrine of the *International Shoe* case is a well-established one, and we note that the Government makes no attack on it here—although it disputes the factual conclusions of the District Court. "This doctrine [the failing company doctrine] has been consistently followed in the litigated cases and has been applied by the enforcement agencies in their merger clearance procedures." Comment, 68 Yale L. J. 1627, 1662 (1959). For example, the Department of Justice has approved the merger of United Press and International News Service under the *International Shoe* doctrine (see 1 CCH Trade Reg. Rep. ¶4207.105 (1958)), and has acquiesced in the acquisition of the only other daily newspaper in New Orleans by the New Orleans Times-Picayune (see III Antitrust Bulletin, No. 5, p. 594 (1958)). The doctrine has also been consistently applied by the Courts and by the Federal Trade Commission, through a process of analysis of the varying financial facts involved in various specific situations.[25]

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product situation. It's not a ten-product situation. It's a many product situation, and it's complicated" (R. 201). Diebold's position is that there are numerous companies producing for its markets, many of them far larger than operations the size of HHM and Diebold (R. 16-22, 137, 540-49).

[25] See *Erie Sand & Gravel Co.* v. *FTC*, 291 F. 2d 279, 280-81 (3d Cir. 1961); *Crown-Zellerbach Corp.* v. *FTC*, 296 F. 2d 800, 831-32 (9th Cir. 1961); *United States* v. *Jerrold Electronics Corp.*, 187 F. Supp. 545, 565 n. 44 (E.D. Pa. 1960), *aff'd*, 365 U.S. 567 (1961); *United States* v. *Maryland & Virginia Milk Producers Ass'n*, 167 F. Supp. 799, 808-09 (D.D.C. 1958); *Pillsbury Co.*, 1960-61 F.T.C. Cases ¶ 29,277; *Farm Journal, Inc.*, 53 F.T.C. 26, 47-48 (1956).

The Government quotes bits of the Courts' factual analyses in these other cases (Gov. Br. 30-31, 34). But, the issues being essentially factual, the question is simply one of analysis of the record of the particular case at bar. *Cf. Commissioner* v. *Duberstein*, 363 U.S. 278, 289-90 (1960).

C. *HHM was, in fact, a Failing Company at the Time of Its Acquisition by Diebold.*—1. At the time of its acquisition by Diebold, the undisputed facts of record conclusively established that HHM was insolvent in the "commercial" or "equity" sense—it was unable to pay its debts in the ordinary course of trade as they fell due.[26] Moreover, its condition was deteriorating; it incurred operating losses of $206,000 between July 1, 1959 and September 10, 1959 (the date of the sale)—an amount larger than its net profit of $186,000 for the entire fiscal year July 1, 1958-June 30, 1959. Its post-acquisition experience amply confirmed its deteriorating position.

The Government does not dispute the essential facts which led the District Court to this conclusion: The company's history was one of always inadequate working capital. 1959 was the second year in a reversal of the growth trend which had supported the company during the '50s (R. 266, 563). The company had always been incapable of adequate internal cash generation (R. 266-67, 562-63). In the spring of 1959, it was saddled with a high-cost Union contract (R. 267, 565-66). Throughout 1959 its essential liquidity ratios drifted lower (R. 256, 267, 557, 563). It began to resort to questionable financial practices in order to maintain a semblance of financial soundness. It arbitrarily held up payment of its trade accounts (R. 429-30, 556, 558-60, 566). It created fictitious balances in its bank accounts through manipulative transactions (R. 554-55, 565). Its debt, all that its bank could law-

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[26] This is the most common use of the term "insolvency." See MacLachlan, Bankruptcy (1956), § 13; cf. Guthmann, Analysis of Financial Statements (1953), p. 64.

fully give it, was heavily current in nature—in fact payable on demand—making its liquidity position even more critical (R. 456-57, 460-61, 565). It consistently and habitually sent out checks to its creditors, and even to its payroll employees, without sufficient funds in its bank to cover them (R. 222c, 223-24, 233). It frequently had a negative real cash position (R. 223-24). It made use of the "black box" technique to delay payment to its creditors (R. 556).

During the summer of 1959, after these conditions had prevailed for several months, operating losses of a heavy nature—at least 10 percent on annual sales—commenced (R. 222b). Even the company's bank balance per statement drifted lower. Its principal balance reached $13.92 shortly before the closing and, in fact, outstanding checks at the time of the closing created a net overall deficit in all of HHM's bank accounts in excess of $35,000 (R. 222b, 231, 562-64). It could not tender a check in settlement of its principal bank account at the closing—being in fact grossly overdrawn on that account (R. 222b). Its net quick ratio had dropped to .03 (R. 557). At the time of closing, the company had past-due bills payable in the amount of roughly $250,000 and currently due bills in the amount of $500.000—roughly three quarters of a million dollars in all (R. 222b, 235, 566).

The company's fortunes did not improve after the acquisition; operating losses continued; infusions of cash to the extent of $840,000 were pumped into HHM; yet orders declined severely (R. 264-65, 557-58, 566-69).

Despite this unquestioned showing—unquestioned except for one patent misstatement of the record by

the Government[27]—the Government claims it is "pure hyperbole" to find, as the District Court did on the basis of the extensive proofs before it, that HHM was "hopelessly insolvent and faced with imminent receivership" (Gov. Br. 30). Rather, the Government alleges that a company in this condition—with a negative bank account and $250,000 in overdue bills payable—"was, according to the customary indicia of business health, in a sound condition" (Gov. Br. 24). We leave it to the Court to decide where the hyperbole lies, and whether the Government's notion of soundness comports with reality.

The Government's Brief is strangely silent on the essential question in the case: How a company in HHM's plight during the summer of 1959 could have survived without merger. It was not able to pay its bills as they matured; it was habitually overdrawn on its bank accounts; its sales were stagnating, thereby imperiling the continuation of its receivables; and its past-due trade debt was $250,000, with an even more substantial current debt payable. Moreover, the company was at the time of acquisition, as events proved, not headed for an improvement in its business, but for even worse times.

Under these circumstances it was evident—and the Government suggests no other alternative—that HHM's condition was such "as to necessitate liquidation or sale" (*International Shoe*, 280 U.S., at 294); that it was "a corporation in failing circumstances, the

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[27] This is the Government's statement that Diebold's figures as to HHM's overdrafts may include amounts for checks which had not been issued by HHM. As we have explained, p. 16, and note 7, p. 12, *supra*, this is simply not the case.

recovery of which to a normal position was, to say the least, in gravest doubt" (*Id.*, at 301); and that it was "a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure" (*Id.*, at 302). These are the very passages of the *International Shoe* opinion which the Government (Gov. Br. 26) sets forth as stating the governing rule of that case; and we submit that the facts at bar clearly present such a picture.

2. In an effort to avoid the impact of the undisputed facts of HHM's condition in 1959, the Government resorts to two approaches. (a). First, it engages in a laborious process of color-matching in which it contrasts the dollar figures relating to the McElwane Company's condition in the *International Shoe* case with those of HHM (Gov. Br. 26-27). Obviously, such a comparison in quantitative terms is pointless. Clearly the McElwane Company was a much larger operation than HHM and, accordingly, its figures for operating losses, bank debt, and trade debt were considerably larger than HHM's: witness the fact that for this company, albeit failing, International gave up stock worth $9,460,000. Again, the precise pattern in which two companies fail is hardly ever likely to be identical; for example, the McElwane Company does not appear to have resorted to any of the extraordinary practices carried on by HHM with respect to its finances. The essential focus of inquiry clearly should be in terms of the facts of the particular financial pathology in question in each case. On the basis of such an inquiry, it is abundantly clear that there was no apparent way in which HHM could have survived as a going concern, and that it faced the grave probability of a business failure.

Moreover, as to the general pattern of the two failures, there is a considerable parallel, as we have indicated, between the situation involved in *International Shoe* and that involved here. Both cases involved companies with some so-called "long-term" prospects. After making an audit of McElwane's books (see 29 F. 2d 518, 521), International Shoe paid close to $10 million for it, and was forced to discharge its liabilities in the due course of trade; and here, albeit without investigation of HHM's books, Diebold paid $3 million for it. — But the crisis in which each acquired company found itself, and which this Court in the *International Shoe* case, and the District Court in this case, found created the "grave probability of a business failure", related to the acquired company's current position in a period of crisis.

(b). The Government's second approach is to stress the long-term performance of HHM. In this showing, as we have indicated, it resorts to such techniques as gross comparison of the entire decade of the '50s with the years of the late '40s; to comparisons, based on census reports, of operating efficiency with that of other companies; and to various other "long-term" financial figures.[28]

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[28] With respect to the Government's general approach, stressing the long-term showing of HHM in terms of its sales volume and its "efficient use" of its working capital—that is, its frequent turnover of capital relative to sales and earnings—a Government publication gives an excellent capsule description of the sort of financial difficulty which will result when such a "long term picture" turns sour in the short run:

> "Somewhat more difficult to see are potential dangers that arise when a business has too great a turnover of its working capital, when too large a volume of business is being supported by its working capital. The business may be very

But the "long term" means very little to a company which will not survive to enjoy it. — The fact of the matter, which the District Court apprehended but which the appellant has not, is that where the issue is the survival of a company beset by a current crisis, data as to the "long view" is not relevant. It is not something which can be put upon the judicial scales and "weighed" together with the facts relating to the current crisis. If the current crisis is not surmounted, the long view means nothing. — With all due respect, it is a financial absurdity to refer to a company as "financially sound" (Gov. Br. 24, 39), when it has a negative cash balance, heavy overdue trade debts, and is undergoing current operating losses, simply on the basis that in preceding years it may have registered figures which appear impressive in the light of a desk-top analysis. The Government's proofs were totally unrelated to HHM's financial crisis in the summer of 1959; and in the days preceding the acquisition. Clearly, the District Court, on the undisputed facts, correctly found that HHM was hopelessly insolvent in 1959, that it faced imminent receivership, and that because of its percarious financial condition could not have long survived as an independent competitor in its lines of business.

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profitable, further obscuring any danger. It should be emphasized that when sales are supported by an inadequate working capital, the very delicate balance of incoming and outgoing funds that results is easily upset with any interruption in the flow of funds, such as the sudden loss of sales or poor collection performance." U. S. Department of Commerce, Guides for Business Analysis and Profit Evaluation (1959), p. 17.

II. THERE WERE NO REAL ALTERNATIVES, SHORT OF BUSINESS FAILURE, TO THE ACQUISITION OF HHM BY DIEBOLD

A. The So-Called Alternative Purchasers

1. The Government contends that there were three non-competing "prospective purchasers", alternative to Diebold, who were interested in acquiring the business of HHM. The Government suggests that this contention has relevance to the issue in this case on two separate theories.[29] *Firstly*, it suggests that the willingness of these other persons to "invest in" the business of HHM "strongly 'suggests that the hopelessness of its position may [have been] open to question and that new capital and new methods [might have been] applied to improve the situation.'" (Quoting Bok, *Section 7 of the Clayton Act and The Merging of Law and Economics*, 74 Harv. L. Rev. 226, 345 (1960)). In other words, "the existence of other prospective pur-

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[29] A commentator frequently relied upon by the Government (Gov. Br. 22, 31, 32) makes it quite clear that it is not established that the existence of alternative purchasers has anything to do with the failing company issue. Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226, 344 (1960). It might well be argued that the sole question in the case is whether the uncontradicted facts demonstrated that at the time of its acquisition HHM was a failing company. The doctrine of *International Shoe* may well mean that at the point where a company is shown to be failing, concern thereafter is wholly for the benefit of creditors, employees, and stockholders of the failing company and the community its serves. The Government does not here, and never has, contested the proposition that a court in receivership or bankruptcy proceedings is entitled to dispose of the assets to the highest bidder. Similarly, the question here might well be taken to be whether, in fact, HHM was in such a failing condition as to remove its acquisition from the thrust of § 7. However, our position is simply that on the facts of the present case the Court need not reach any question as to the implications of the existence of *real* alternative purchasers, offering live alternatives to the acquisition made.

chasers may . . . show that the company is not 'failing'." (Gov. Br. 31).

But obviously no such conclusion can follow in this case, even assuming a serious interest on the part of the so-called alternative purchasers to whom the Government has reference. This is because the record clearly demonstrates that none of the three parties in question had the slightest idea of what the actual financial condition of HHM was in 1959. Therefore, any interest they may have indicated in "investing in" HHM certainly is no evidence contradicting the clear record of HHM's desperate financial plight in the summer of 1959, as later disclosed.

2. The Government alternatively suggests, *secondly*, that the existence of other prospective purchasers "may require the rejection of the [failing company] defense without regard to the firm's financial position." (Gov. Br. 31). This is because, in the Government's theory, the acquisition and operation of HHM by a non-competing alternative purchaser would have permitted the firm to continue as a competitive factor. From this, the Government argues (in contradiction to a position it has taken administratively),[30] that

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[30] When the *New Orleans Times-Picayune* acquired the *New Orleans Item*, there was included a provision for a resale to any potential noncompeting buyer by the acquiring company, if such a noncompeting buyer could be found within 60 days. However, the alternative, noncompeting buyer would be required to buy at the purchase price of $3,400,000 paid by the *Times-Picayune*, plus expenses of up to $75,000. "In announcing the acquisition it was stated that the Justice Department had reviewed the transaction and acquiesced. . . . In the event that a buyer does not appear, the *Item* will be combined with its competitor, the *New Orleans States* [owned by the *Times-Picayune*]." III Antitrust Bulletin, No. 5, p. 594 (1958).

"where such a sale is possible, the acquisition of the company by a competitor, even at a higher price, may violate section 7." (Gov. Br. 32). Clearly, as to this point, there must be more than a mere showing of "interest" by parties other than the acquiring firm; it should appear that there were live possibilities of sale to alternative purchasers, at the time of the financial crisis.

The uncontroverted facts of record here do not furnish any basis for the application of this legal theory of the Government, even assuming its validity. The record is clear that none of the three "interests" in question ever considered that it had made a definite offer for the business of HHM. Their "interest" seems to have been primarily the product of the promotions of middlemen; and, except in the case of Boyce, even the activities of the middlemen were not extensive. Certainly none of them presented a live possibility of being an alternative purchaser to Diebold in HHM's financial crisis in 1959:

(a) Colonel T. C. Davis' "interest" was clearly the result, as revealed by the record, of the promotional efforts of a prospective middleman—an assistant treasurer of the Bank of New York. The record clearly reveals that the contacts between Colonel Davis and Mosman, although pushed by Van Ness, were never strongly pursued on either side by the putative parties. It hardly reveals any serious expression of interest by Davis. And the record makes clear Mosman's unwillingness to make his books available to Davis—he delayed one meeting on the representation that the company was still closing its books—and there never, in fact, was any disclosure of HHM's financial position by Mosman to Davis. (R. 274-81, 283-88).

(b) While Boyce's contacts with Mosman were somewhat more extensive, he, too, swore that he never made an offer for HHM. In Boyce's case, a prospective middleman, envisaging a finder's fee in excess of $100,000, prepared an extensive pamphlet on HHM's financial prospects, replete with hypothetical projections through 1968,—and obviously constructed in the heat of imagination, inasmuch as Mosman had not permitted access to his books to the author of the pamphlet. Boyce's "interest" was linked, in this pamphlet, with that of a "purchasing group"—which had not been formed; and a public stock offering was also contemplated as part of the promotion of the deal. Boyce's "interest" was emphasized, in the promotional material by the middleman, "as a matter of psychology," in dealing with him (R. 347).

The circumstance that stamps the Boyce "interest" in HHM with the final certificate of unreality is, of course, the fact that no disclosure of the real financial condition of HHM was made by Mosman to Boyce or to the promoters associated with him.[31] This, despite the fact that Boyce's contacts with Mosman dragged on for over a year (R. 345). It must be remembered that before the consummation of a deal commenced on such a basis, a "purchasing group" which had not yet been formed, there would have to be actual financial studies and verifications made of the company to be acquired. Indeed, the one realistic note in the otherwise imaginative promotional pamphlet stressed (R. 348):

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[31] Boyce, like Diebold, was permitted a look at HHM's physical facilities (R. 8-9, 345). The physical facilities were of particular importance to Diebold's needs (R. 13-14; R. 361), but the financial side of HHM—which the Boyce "syndicate's" promoters never saw—was evidently of primary importance to them (R. 348, 351-56).

> It should be distinctly understood the following in no way constitutes an offer, but rather a basis for discussion.
>
> . . .
>
> The purchaser must have an opportunity and sufficient time for necessary verifications and to supply a firm proposal, . . .

And of course disclosure of financial data would be required with respect to the contemplated public stock offering. What the effect of an accurate financial picture of HHM would have been on such a purchasing syndicate and upon a public stock offering is obvious.

The nub of the matter is that the Boyce "syndicate," assuming that it ever came into a stage of completed formation, would not have had any interest in purchasing a failing company; their promoters, in their ignorance, had no thought that this was what HHM was; and public stock offerings to finance acquisitions at near insolvency sales are somewhat rare. Boyce's "group", unlike Diebold, would (as it stated) only have purchased HHM on the basis of a full financial disclosure and verification (R. 348); but a full disclosure obviously would have been fatal to the sale. In short, it cannot be said that sale to Boyce *et al.*, would have been a live possibility on the only basis—full financial disclosure—on which they indicated interest.

(c) We note that the Government scarcely presses its argument (Gov. Br. 32-33) that the clothes wringer and drier firm, Lovell Manufacturing Company, was a serious "alternative purchaser". This company appears never to have followed up an original contact with Mosman (R. 270, 272-74). It, of course, like the others, was never allowed access to HHM's books.

3. The Government observes that "acquisitions of major industrial concerns necessarily involve exploratory discussions and investigations, and a prospective purchaser is no less 'available' or 'bona fide' because he has not yet reached the point of making a firm offer." (Gov. Br. 34). But it must also be recognized as a fact of life that in the business world there are many, many more "expressions of interest" and "feelers" as to acquisitions than there are serious considerations of such purchases. As the Court below noted out of the wealth of its experience in reorganization cases, there is many an expression of hope but few concrete offers (R. 327).

And, in any realistic consideration, the activities of those individuals so evocatively termed "finders" must be taken into account; their presence, certainly apparent on the present record, greatly increases the number of acquisition "feelers", not of a serious nature, in the every-day business world. Accordingly, it would confound common experience to regard every person making an "expression of interest" as a serious alternative purchaser in considering a failing-company issue in a Section 7 case.[32]

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[32] Moreover, in view of the difficulties of running down such will-of-the-wisps at trial, and the practical difficulties inherent in the failing company's approach to potential acquirers, see Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226, 346 (1960), there should be a strong policy supporting judicial consideration only of alternatives of considerably more solidity than those revealed here. As a commentator has pointed out, it is hard for the acquired firm to be "severed from the defendant months or even years after the merger on the strength of an offer which may no longer be outstanding." (*Ibid.*) It is even harder for it to be severed on the basis of some nearly forgotten "expression of interest" on the part of a promoter.

The Government, in an effort to explain the lack of alternative firm offers to Diebold's for HHM, suggests (Gov. Br. 34) that in view of the fact that Mosman never furnished any of the three interests in question with financial data or operating figures, "it is hardly surprising that no other firm offers [than Diebold's] were made". The obvious answer to this observation is that the furnishing of such data or figures—the figures being what they were during 1959—would hardly have been a stimulant to a firm offer on the part of any of the three interests involved, or to the outside financing institutions on which parties of such a nature obviously would have had to depend. Despite the above-quoted language, the Government can scarcely contend that the revelations that HHM was unable to pay its bills in the due course of business; that it was heavily overdrawn on its bank accounts; that it was engaging in transactions to create fictitious bank balances; and that it had commenced to incur operating losses, would have been a stimulant to the closing of a deal with any of the three interests in question.

* * *

Accordingly, it is clear that the District Court correctly found that "the facts concerning HHM's true financial condition were never disclosed to Diebold or to any of the promoters [the so-called alternative purchasers]. HHM's opportunity to achieve a sale on the terms it sought, and obtained from Diebold, was contingent upon the swift conclusion of a sale without exhaustive analysis of its books and records . . . Diebold was the only bona fide prospective purchaser for HHM's business." (Fdgs. 29-30, R. 569).

B. Alternative Means of Maintaining HHM's Business

As we have noted, the Government has not come forward with any suggestion of a serious alternative to the acquisition of HHM's assets by Diebold, as an escape from business failure for HHM. In lieu of such a showing, it reverts to a process of "color matching" of certain of the factual details in this case against the factual details of the *International Shoe* case. The Government stresses the fact that in *International Shoe*, there were among the officers of the company, as they later testified, lengthy discussions of the alternatives to sale (Gov. Br. 35-36). There were, the Government points out, no such "discussions" here. And obviously not; the record is clear that HHM was, in effect, a one-man operation—that of Warren Mosman who owned 90 percent of its stock (R. 25). The record, however, reveals that Mosman considered liquidation in 1959, and seriously considered recommending liquidation to the Board of Directors; a recommendation which, in view of the fact that the Board consisted of his subordinate employees, would doubtless have met with affirmative action. Clearly, the question whether the condition of a company is such that it is in danger of disappearance, unless bought out, is not one that can be decided on the basis of how much its officers talk about the matter.

The Government, apparently as probative of some element of its case, also refers to the fact that Mosman did not discuss HHM's failing condition with Diebold before the closing; Mosman stated only, at this stage, that his motive for selling was not HHM's financial condition but tax considerations and other personal considerations (Gov. Br. 37). In view of the fact that Diebold bought HHM without disclosure of its

financial condition, we trust it will not be taken as an expression of cynicism to say that it was obvious why Mosman did not reveal its condition at this time.

* * *

In summary, the Government has articulated no serious alternative to an acquisition of HHM as a method of its surviving the 1959 crisis. Speculations as to alternative possibilities here, we submit, would be even less substantial and more pointless than the afterthought alternatives to an outright sale, which were raised in the *International Shoe* case and which this Court declared were matters as to which "one guess is as good as another" and which might "be dismissed as lying wholly within the realm of speculation." (280 U.S., at 301).

III. THE USE OF SUMMARY JUDGMENT WAS PROPER IN THIS CASE

As a subsidiary point, after considerable argument to the effect that the record dictated a finding in its favor on the failing company issue as a matter of law on the undisputed facts,[33] the Government contends that "even if we are wrong," (Gov. Br. 39), the Court below erred in entering summary judgment.

A. The Government does not take the position that a resolution of the "failing company" issue before plenary trial of the remaining § 7 issues, such as was

[33] The Government's position appears to be technically incorrect. Even if HHM had not been strictly within the rule of the *International Shoe* case, but simply in an unhealthy state of finances not amounting to "failing company" status, there would appear no reason why Diebold should be precluded from showing, upon the trial of the action, all the financial facts as to HHM's impaired condition which might be relevant to an informed determination of the effect of the acquisition upon competition.

employed in the present case, is generally inappropriate. Obviously such a preliminary resolution of a "failing company" issue, either by way of summary judgment, or by way of a separate, partial trial devoted to the issue, will often be indicated by sound judicial administration in the context of the antitrust "big case".[34] In fact, the Government has, on occasion, consented to the use of such a preliminary procedure, by way of partial trial, for the resolution of a "failing company" issue. See *United States* v. *Cunningham Drug Stores, Inc.*, Civil No. 20266, E.D. Mich., Stipulation and Order filed May 16, 1961.[35]

B. The Government's contention appears simply to be that the vehicle of summary judgment was inappropriate for the resolution of the "failing company" issue in this antitrust case. In this context it cites the recent decision of this Court in *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U.S. 464 (1962). *Poller*, to be sure, reaffirms the salutary principle that issues of conspiracy and of intent in an antitrust case are not readily resolvable on a Motion for Summary Judgment. But of course *Poller* does not hold—nor could it have held in the light of Rule 56—that summary judgment procedures are without applicability in antitrust cases. Where the question presented is a matter of the proper inferences to be drawn from undisputed financial or economic facts, and no displacement of the right of trial by jury is presented, summary judgment is, obviously, a valuable means of resolution of otherwise protracted antitrust issues. Its potentialities for avoiding

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[34] See *Seminar on Protracted Cases*, 23 F.R.D. 319, 399, 604 (1958).

[35] A copy of these documents is attached as Appendix A.

the procedural and administrative snarls of the "big case" are clear. In such contexts, summary judgment has repeatedly received the approval of this Court in civil antitrust litigation. See *Associated Press* v. *United States*, 326 U.S. 1 (1945); *International Salt Co.* v. *United States*, 332 U.S. 392 (1947); *Northern Pacific R. Co.* v. *United States*, 356 U.S. 1 (1958). And see also *United States* v. *White Motor Co.*, 194 F. Supp. 562 (N.D. Ohio 1961), defendant's appeal docketed as No. 619, this Term.

The issue in this case was, of course, not one of an alleged conspiracy to restrain trade. The issue was one of the conclusions to be drawn from undisputed financial facts and data—indeed, from the same basic data which was used by both parties in contending for the Court's judgment below. Obviously, in such a context the use of summary judgment, in an appropriate case, is perfectly proper.

C. However, the Government points to certain alleged instances of disputed facts and "inferences" which, it argues, should have precluded the grant of summary judgment in the case at bar. But no genuine dispute as to any material fact at issue in the Court below is disclosed by the Government's presentation.

1. The Government contends (Gov. Br. 39-41) that a factual dispute was created by the conclusory affidavits of the Government economist and the Government accountant that before the acquisition HHM was "in a sound condition and not in a failing condition nor heading in that direction." (Gov. Br. 39-40). But, as we have indicated in the Statement of Facts, these conclusions were founded upon the same basic

data upon which Diebold moved for Summary Judgment, and upon certain public financial documents as to whose existence there was no dispute. That the Government economist and accountant should draw different conclusions from this basic data from the conclusions Diebold drew hardly creates a genuine dispute as to a material issue of fact. Certainly the grant of summary judgment should not be precluded by the circumstance, for example, that a Government economist is willing to swear that a company which is constantly overdrawn[36] on its bank accounts and which has fallen into the series of manifestations of hopelessly insolvent position which were evident in HHM in 1959 is nonetheless "in a sound financial condition." (R. 600).

2. For the reasons we have already outlined, the Government's figures and comparisons as to HHM's long-term financial position did not create a genuine factual issue, as suggested by the Government (Gov. Br. 39). Here again there was no dispute as to the underlying data. It was Diebold's legal contention that these "long-term" figures were irrelevant and noncontrolling on the issue before the Court. This con-

[36] The Government also suggests that there may be a factual dispute as to whether HHM was "overdrawn" on its bank accounts (Gov. Br. 41). But there is no question—except as created by the Government's misreading of the record (see note 7, p. 12, *supra*)—as to the basic facts. HHM habitually and to a substantial extent during 1959 issued checks without money in the bank to cover them. However, when these checks reached the drawee, there were (with only slight margins at times) sufficient funds to pay them. The Government's contention that HHM was never overdrawn, then, is simply a matter of characterization of these basic facts; and, as we have demonstrated, the Government's characterization does not accord with accounting usage (see note 6, p. 11, *supra*).

tention obviously raised an issue which could be decided as well upon a Motion for Summary Judgment as upon the introduction of the basic documents on trial through an identifying witness on the stand.

3. The Government states, without pointing to any factual conflict, that there were factual disputes as to the other so-called "alternative" purchasers of HHM. But we submit that there was no dispute as to any fact material to the judgment. We have demonstrated that the undisputed facts of record indicate that none of these interests ever considered that he had made a definite offer for HHM, and that none had received accurate financial data about HHM by way of any disclosure from Mosman. The record is clear, without conflict as to the basic, material facts, and was fully adequate for the District Court's judgment that none of the three interests involved could be considered a serious possibility as an alternative purchaser of a company in HHM's condition.

4. Finally, the Government, presumably in an effort to generate an issue suggestive of the *Poller* case, suggests that summary judgment was improper in the light of an alleged conflict as to whether Diebold had an anti-competitive *intent* in acquiring HHM. This issue as to motive—which does not even appear to have been raised by the Government in the District Court—was not in fact the subject of conflicting proofs below. It was undisputed on the record that Diebold was in need of additional plant space to relieve its overcrowded facilities in Canton, Ohio, where efficient economic expansion was not feasible (Fdg. 27, R. 69; R. 13, 360). HHM's facilities permitted Diebold to have a more complete product line, and compete more effectively with its competitors such as Shaw-

Walker and Sperry Rand (R. 13-14, 361). The Government took no exception to Diebold's proposed finding to this effect.[37]

To generate an "issue" to the contrary for the first time on appeal, the Government grasps at various straws. The Government points to the fact that Diebold may have paid more for HHM than it was worth.[38] But in the light of Diebold's general ignorance as to the true financial condition of HHM, this bit of "evidence", at most barely probative, becomes meaningless. Next, the Government mentions a record item to the effect that on a completely unrelated occasion a representative of Diebold had approached a small businessman, having no connection with HHM, and made an anti-competitive proposition to him (Gov. Br. 43, R. 396-97). It staggers the imagination to assume, as the Government evidently does, that such an incident is sufficient to put a stain upon a company's motives for the rest of its business history. Lastly, the Government suggests that Diebold's closing down of HHM's sales offices and the reductions in force at its HHM Division were not due—as the evidence of record

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[37] See the unprinted "Plaintiff's Objection to Defendant Diebold's Proposed Findings of Fact and Conclusions of Law" which attacked Diebold's view of the record in great detail, but which did not dispute the proposed finding (Fdg. 27), which the District Court adopted, as to Diebold's. motive in the acquisition

[38] The Government's expression of the purchase price paid is somewhat misleading. The Government states "that Diebold paid $3,000,000 in cash and agreed to assume liabilities of about $1,800,000 for the assets of a company whose total net worth was approximately $2,300,000" (Gov. Br. 42). Since liabilities are deducted before net worth is reached, the suggested comparison between $4,800,000 and $2,300,000 is improper. Diebold purchased HHM for its manufacturing facilities, which Diebold urgently needed (R. 361, 389).

indisputably shows them to be—to HHM's deteriorating business condition, but to anti-competitive motives (Gov. Br. 43). The short answer here is that, as stated, the record is clear as to the reason for these shrinkages in HHM's business. If the Government wished to controvert Diebold on this, it had the opportunity of filing proofs to the contrary, or of making an affidavit under Rule 56(f) suggesting the existence of a genuine factual dispute based on facts to which the party making the affidavit did not have immediate access.[39] No such proof was tendered nor was any such

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[39] See 6 Moore, Federal Practice (2d ed.), pp. 2345-46. The Rule 56(f) procedure affords the party making the affidavit an opportunity to take further proof, and have further discovery by deposition or otherwise, in an effort to locate substantiation for the assertions of factual dispute which he makes. The Government, in fact, made one use of the Rule 56(f) procedure in the District Court (R. 281), but never sought to use it in respect of the matters now raised as an afterthought on appeal. Where a party does not make use of the Rule 56(f) procedure, it is of course bound by the record on the summary judgment motion as it stands. *Dyer* v. *McDougall*, 201 F. 2d 265 (2d Cir. 1952).

Another afterthought issue raised by the Government (Gov. Br. 41-42) seems not only to be an afterthought but to be altogether immaterial. The Government for the first time on appeal contends that summary judgment precluded it from showing that the worst part of the deterioration of HHM's financial condition came after HHM and Diebold had orally agreed on the basic terms of the acquisition, which required Diebold to pay all of HHM's liabilities unpaid at the date of closing. But inasmuch as HHM was clearly in a failing status by the date of the acquisition, this point appears totally immaterial. If here had been no acquisition, whenever contracted for, HHM could not have survived for any period of time after September 1959, the date when it was in fact acquired. If the Government's reference should be construed as a suggestion that Mosman neglected the payment of his accounts payable because Diebold had undertaken their payment, and that therefore the catastrophic figures for the summer of 1959 are misleading, it must be remembered that the enormous backlog of accounts payable which HHM had accumu-

affidavit filed; and the whole "issue", in fact, was not raised in the District Court.

It would make a mockery of the summary judgment rule to permit spurious "issues" of this nature to be introduced into the case for the first time in a brief on appeal rather than through presentation to the District Court in the manner prescribed by Rule 56. Yet this issue has been raised by the Government for the first time on appeal to this Court.

* * *

Clearly, the undisputed basic facts here called for summary judgment in favor of Diebold. The various suggestions of factual dispute raised by the Government either concern conclusions to be drawn from the basic facts; concern immaterial matters; or are simply afterthoughts on appeal not supported by any actual conflict in the record before the District Court. Obviously, none of these can preclude the entry of summary judgment. The record was an extensive one; the issues were not those of intent, conspiracy, or other matters difficult to resolve without trial. The task of analysis of the financial figures of record would have been the same had the figures been introduced from the witness stand by identifying witnesses. The grant of summary judgment was appropriate in the context of the case.

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lated by the time of the closing was not matched by any accumulation of cash with which to pay the accounts. Rather, HHM had a negative cash position. No dividends were paid in the summer of 1959. If HHM were not insolvent in the summer of 1959, but Mosman were simply holding up payment of its accounts payable, a buildup in its cash position, instead of the contrary, would have been experienced.

CONCLUSION

The Government has pointed to no error of law committed by the District Court, and in fact there is no serious dispute between the parties as to the legal principles involved in this case. The undisputed facts revealed a unique and almost bizarre story of HHM's desperate financial condition in 1959; and of the extraordinary measures which the company used in its efforts to conceal and, unsuccessfully, to cope with that condition. The District Court thoroughly canvassed the financial, economic and other facts introduced in the voluminous record by the parties. The District Court's conclusion was the correct one upon the undisputed facts; that HHM at the time of its acquisition was in such financial condition that its acquisition could not have the substantially adverse effect on competition defined in Section 7 of the Clayton Act.

Accordingly, it is respectfully urged that the judgment of the District Court be affirmed.

Respectfully submitted,

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April 1962

APPENDIX A

Stipulation and Order in United States v. Cunningham Drug Stores, Inc., Civil No. 20266, E. D. Mich.

[Caption omitted]

Stipulation Re Trial of Issues Raised by Paragraph 15 of Answer as First Step in Trial.

It is hereby stipulated and agreed by and between the parties, by their respective counsel, that all issues of fact and law raised by Paragraph 15 of the Answer* be tried as the first step in the trial, which may or may not be dispositive of the case as the Court may determine, and that pre-trial procedures be directed to those issues, and preparation for and trial of the remaining issues be held in abeyance pending such trial.

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* The portion raising the "failing company" issue.

[Caption omitted]

Order Re Trial of Issues Raised by Paragraph 15 of Answer as First Step in Trial.

Upon reading and filing the Stipulation of the parties attached hereto, It Is Hereby Ordered that all issues of fact and law raised by Paragraph 15 of the Answer be tried as the first step in the trial, which may or may not be dispositive of the case as the Court may determine, and that pre-trial procedures be directed to those issues, and preparation for and trial of the remaining issues be held in abeyance pending such trial.

HONORABLE THEODORE LEVIN
District Judge

Done at the Federal Courthouse,
Detroit, Michigan, this 16th
day of May, 1961.

SUPREME COURT OF THE UNITED STATES

No. 286.—October Term, 1961.

United States, Appellant, v. Diebold, Incorporated.	On Appeal from the United States District Court for the Southern District of Ohio.

[May 14, 1962.]

Per Curiam.

This is a civil antitrust suit by the Government challenging Diebold's acquisition of the assets of the Herring-Hall-Marvin Safe Company as being violative of § 7 of the Clayton Act. On motion of Diebold the District Court entered summary judgment against the Government on the ground that the acquired firm was a "failing company" under the doctrine of *International Shoe Co.* v. *Federal Trade Comm'n*, 280 U. S. 291 (1930). The case is here on direct appeal. 368 U. S. 894.

In determining that the acquisition of the assets of Herring-Hall-Marvin Safe Company was not a violation of § 7, the District Court acted upon its findings that "HHM was hopelessly insolvent and faced with imminent receivership" and that "Diebold was the only bona fide prospective purchaser for HHM's business." The latter finding represents at least in part the resolution of a head-on factual controversy as revealed by the materials before the District Court of whether other offers for HHM's assets or business were actually made. In any event both findings represent a choice of inferences to be drawn from the subsidiary facts contained in the affidavits, attached exhibits, and depositions submitted below. On summary judgment the inferences to be drawn from the underlying facts contained in such materials must be viewed in the light most favorable to the party opposing the motion. A study of the record in this light leads us to believe that inferences contrary to those

drawn by the trial court might be permissible. The materials before the District Court having thus raised a genuine issue as to ultimate facts material to the rule of *International Shoe Co.* v. *Federal Trade Comm'n*, it was improper for the District Court to decide the applicability of the rule on a motion for summary judgment. Fed. Rules Civ. Proc., 56 (c).

Reversed and remanded.

MR. JUSTICE FRANKFURTER took no part in the consideration or decision of this case.